

ST 00-8

Tax Type: Sales Tax

**Issue: Books and Records Insufficient
Disallowed General Deductions
Bearing the Burden for Payment of Tax (Claim Issues)**

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**“ABC FOOD & LIQUOR, INC.,
Taxpayer.**

Docket No. 98-ST-0000
IBT No. 0000-0000
NTL SF-1997000000000000
John E. White,
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Akram Zanayad appeared for “ABC Food & Liquor, Inc.”; John Alshuler appeared for the Illinois Department of Revenue.

Synopsis:

Following audit, the Illinois Department of Revenue (“Department”) issued a Notice of Tax Liability (“NTL”) to “ABC Food & Liquor, Inc.” (“ABC” or “taxpayer”) that assessed Retailers’ Occupation Tax regarding “ABC’s” sales during the period from January 1, 1994 through and including December 31, 1996. Taxpayer protested that NTL and asked for a hearing. In a pre-hearing order, the parties agreed that the only two issues to be resolved were whether taxpayer should have been allowed a deduction for food stamps, and whether the Department’s audit methods were proper.

The hearing was held at the Department’s offices in Chicago. Taxpayer offered the testimony of its owner and current president, a copy of one return filed during the audit period, and copies of workpapers prepared by the Department’s auditor. I have

reviewed the evidence offered at hearing, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director resolve both issues in favor of the Department.

Findings of Fact:

1. Taxpayer conducts business as a retailer of food and liquor at “1111 West Anystreet”, in Chicago. *See* Taxpayer Ex. 1; Department Ex. 1, p. 2 (audit correction and/or determination of tax due).
2. The Department conducted an audit of taxpayer’s business for the period from 1/1/94 through 12/31/96. Department Ex. 1, p. 2; Taxpayer Ex. 2, *passim* (Taxpayer exhibit 2 consists of six pages of schedules prepared by the Department’s auditor regarding the Department’s audit of taxpayer).
3. During the audit period, “Ronald Razza” (“Razza”) was taxpayer’s owner and manager. Hearing Transcript (“Tr.”) pp. 11-12. In 1996, he was the corporation’s president. *Id.*
4. “Razza” gave books and records to the Department’s auditor. Tr. pp. 16-17; Taxpayer Ex. 2; Department Ex. 1, p. 2 (on the correction of taxpayer’s return form, the auditor indicated that the basis of her computation was books and records).
5. On the returns “ABC” filed regarding the months of 7/95 through 12/95, it reported food stamp deductions in the aggregate amount of \$257,302. Taxpayer Ex. 2, p. 3 (titled, Schedule 4A, Food Deduction Claimed). On the returns “ABC” filed regarding the months of 1/96 through 8/96, it reported food stamp deductions in the aggregate amount of \$528,339. *Id.*

6. After reviewing taxpayer's books and records, the auditor determined that taxpayer had unreported high rate sales, and she determined that the deductions taxpayer claimed for food stamps should be disallowed. Taxpayer Ex. 2, pp. 3, 5 (page 5 of the exhibit is titled, Schedule 1[,], Summary Analysis, which schedule details each of the return items that were affected by the audit). Finally, she determined that the deductions taxpayer claimed for sales of newspapers and for sales of food at the low rate of tax should be disallowed. Taxpayer Ex. 2, p. 5.
7. Where an item of deduction was disallowed at audit, the amount of the deduction previously claimed on "ABC's" returns was included as part of "ABC's" taxable gross receipts for the audit period. Taxpayer Ex. 2, p. 5.
8. When calculating the amount of food deductions to which taxpayer was entitled and the amount of unreported sales, the auditor reviewed records of taxpayer's purchases of tangible personal property. Taxpayer Ex. 1, pp. 1 (titled, Schedule 3A), 3.
9. Schedule 3A of the auditor's workpapers includes entries for each month in the audit period, and shows: taxpayer's cost of tangible personal property purchased for resale; a markup of 21% added to such costs; the amount of gross receipts reported on taxpayer's Retailers' Occupation Tax ("ROT") returns as being from taxpayer's sales of general merchandise; and the difference between the estimated sales and taxpayer's reported sales. Taxpayer Ex. 2, p. 1; Taxpayer Ex. 1 (the amount of general merchandise sales claimed on taxpayer's return for 4/96 corresponds to the auditor's Schedule 3A entries (from "ABC's" returns) for the same period).

10. Schedule 4A of the auditor's workpapers includes entries for the months of 7/95 through 12/96, and shows, *inter alia*: taxpayer's cost of food purchased for resale; a markup of 21% added to such costs; the amount of gross receipts reported on taxpayer's Retailers' Occupation Tax ("ROT") returns for sales of food; the difference between the estimated sales and taxpayer's reported sales; and the amount of food stamps claimed as deductions on taxpayer's returns. Taxpayer Ex. 2, p. 3; *see also*, Taxpayer Ex. 1 (the amounts of food stamp and other deductions claimed on taxpayer's return for 4/96 corresponds to the auditor's Schedule 4A entries (from "ABC's" returns) for the same period).

Conclusions of Law:

At a pre-hearing conference, the parties agreed that the two issues to be resolved at hearing were whether "the Department's calculation of taxable gross receipts should be revised to take into account the amount of food stamps taxpayer received during the course of its business ... [and] [w]hether the Department's audit methods were proper." *See* Pre-Hearing Order. I will address the second issue first.

The Department's correction of returns filed by the taxpayer is deemed to be *prima facie* correct and *prima facie* evidence of the correctness of the amount of tax shown to be due therein. 35 ILCS 120/4; Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958). The Department's *prima facie* case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d

826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer must present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

The Retailers' Occupation Tax Act ("ROTA") does not require the Department to substantiate the basis for the corrected return or produce the auditor who computed it in order to support its prima facie case. Fillichio v. Department of Revenue 15 Ill.2d 327, 155 N.E.2d 3 (1958). Where a corrected return is challenged, the record must only demonstrate that the Department's method of preparing the corrected return meets some minimum standard of reasonableness. Elkay Manufacturing Co. v. Sweet, 202 Ill. App. 3d 466, 470, 559 N.E.2d 1058, 1060 (1st Dist. 1990). The reasonableness standard is based upon § 4 of the ROTA, which requires the Department to correct returns according to its best judgment and information. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 208, 577 N.E.2d 1278, 1281 (1st Dist. 1991); Masini v. Department of Revenue, 60 Ill. App. 3d 11, 14, 376 N.E.2d 324, 327 (1st Dist. 1978).

Here, the record supports a conclusion that the Department corrected taxpayer's returns according to its best judgment and information, and therefore, that the Department's audit methods were reasonable. The reasonableness of the Department's audit methods was established by taxpayer's own exhibit of the auditor's workpapers. *See* Taxpayer Ex. 2; Tr. pp. 22-23. Initially, the workpapers particularly identified the items of taxpayer's returns that were changed because of the audit. Taxpayer Ex. 2, p. 5. The Department auditor's workpapers also established that, while taxpayer might have tendered books and records to the Department's auditor, the records that were produced were incomplete and

did not include a record of “ABC’s” actual gross daily sales for the audit period. *See* 86 Ill. Admin. Code §§ 130.805(a) (What Records Constitute Minimum Requirement), 130.810(b) (Records Required to Support Deductions). Nor did “Razza” ever testify that he kept records that showed what taxpayer’s gross daily receipts were for the entire audit period. *See* Tr. p. 17. Without records showing taxpayer’s actual daily gross receipts, the auditor was obliged to estimate “ABC’s” taxable gross receipts during the audit period. *See Goldfarb v. Department of Revenue*, 411 Ill. 573, 578, 104 N.E.2d 606, 608 (1952) (the Department may not disregard a taxpayer’s books and records showing daily gross receipts, and then estimate tax liability using other records); 86 Ill. Admin. Code § 130.805(a).

Taxpayer Exhibit 2 further reflects that “ABC” did not keep and maintain records showing all of its purchases for resale. Taxpayer Ex. 2, pp. 1, 3. For example, the first column (titled “Purchases”) on page 1 of Taxpayer’s Exhibit 2 has the same number repeated for each month from 9/95 through 12/96. That occurs where an auditor has projected an estimate of taxpayer’s purchases, because records do not exist from which the true amounts of purchases might be ascertained. The first column (titled, “Dearborn Purchases”) of page 3 of the same exhibit similarly has zeros or no entries for the dollar amounts of food purchased for resale during the months of 7/95, 9/95 through 11/95, and 1/96 through 4/96. Taxpayer Ex. 2, p. 3 (column 1). Those entries, or lack thereof, show that taxpayer lacked records that reflected its cost price of food purchased for resale during those months. *Id.*

So, while Taxpayer Ex. 2 and Department Ex. 1 reflect that the auditor, in fact, reviewed documents tendered to her by “ABC” (*see* Tr. pp. 17-18 (“Razza”)), no

documentary evidence was offered at hearing to support taxpayer's argument that the Department ignored any of the books and records that were tendered for audit.¹ Rather, this record supports a conclusion that the auditor had to correct "ABC's" returns using the incomplete records that were tendered to her by taxpayer and, to fill in the gaps, the auditor had to use the best information that was available to her. *See* 35 ILCS 120/4; Elkay Manufacturing Co. v. Sweet, 202 Ill. App. 3d at 470, 559 N.E.2d at 1060.

The primary issue in this matter involves deductions "ABC" reported for gross receipts in the form of food stamps. To support its claim that the auditor wrongly disallowed the deductions reported on its returns, taxpayer offered a copy of one of the monthly returns it filed during the audit period. *See* Taxpayer Ex. 1. The numbers reported on a taxpayer's returns, however, do not constitute evidence that is probative of the question presented here, that is, whether the numbers reported on "ABC's" monthly returns are true and accurate statements of the amount of food stamps it received from selling food to others for use or consumption. Rather, it is the entries within a taxpayer's books and records that are supposed to be the source for the numbers reported on its tax returns. Taxpayer, therefore, cannot prove entitlement to a deduction simply by introducing the return on which the deduction is reported. *See* 35 ILCS 120/7 ("It shall be presumed that all sales of tangible personal property shall be subject to tax under this Act until the contrary is established, and the burden of that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable.").

¹ And if the auditor, in fact, made an error, and really did ignore taxpayer's books and records, the only way I would be able to correct that error in taxpayer's favor would be if I had taxpayer's books and records to review. I cannot know what the contents of taxpayer's books and records would reveal if I do not have possession of them.

Taxpayer also offered the testimony of its owner and manager, “Razza”. He testified, in summary, that “ABC” made sales and took food stamps in return, and that he deposited the food stamps “ABC” received from customers into a bank account. Tr. pp. 15-16, 18. He gave “ABC’s” bookkeeper the receipts from the business, he told him what the company’s food stamp, food and liquor sales were, and the bookkeeper prepared “ABC’s” returns. Tr. pp. 14, 19. He gave the Department’s auditor all of the books and records he had for “ABC”, and, “Razza” testified, she never returned them to him. Tr. pp. 17-18.² He also testified that he gave the auditor written permission to ask the United States Department of Agriculture for information regarding the amount of food stamps it received from “ABC’s” business, but the auditor refused to do so. Tr. p. 18.

The Department treats gross receipts from the sale of food for food stamps as nontaxable sales. In a 1985 Informational Bulletin, the Department informed all retailers of food that:

We do not consider receipts from this source to be subject to sales tax since the food stamp program is federally funded. Do not charge state, local, or mass transit taxes on such sales.

You should include receipts from food stamps in Line 1, "Total Receipts", of your return (Form RR-1-A)

² I give no weight to “Razza’s” testimony that the Department’s auditor never returned the books and records she reviewed during her audit. Taxpayer was represented by competent counsel, and taxpayer engaged in pre-trial discovery authorized by Department regulations and Illinois Supreme Court Rule. Tr. pp. 25-26; Order, dated 6/2/99 (reflecting that “ABC” deposed the Department’s auditor before the hearing in this matter). Had the Department really retained custody of taxpayer’s original records, then “ABC” certainly knew where those records might be obtained. Taxpayer’s counsel could have used the discovery methods available to him to obtain whatever records the Department may have had, for introduction at hearing. *See* 86 Ill. Admin. Code §§ 200.125, 200.130; Ill. Sup. Ct. R. § 204(a)(4) (Production of Documents in Lieu of Appearance of Deponent). Had that been unsuccessful, taxpayer could have served the Department with a 237(b) notice to produce the auditor to testify at hearing, as well as any documents belonging to taxpayer that were allegedly retained by her following the audit, which were previously the subject of discovery. *See* Ill. Sup. Ct. R. § 237(b). Had such documents not been produced in response thereto, taxpayer would be entitled to any sanction authorized by Illinois Supreme Court Rule 219(c).

with all other receipts. Then deduct on Line 11, "Food Stamps", the receipts from these sales.

Informational Bulletin FY85-19. On the return it offered as evidence at hearing, "ABC" reported the food stamp sales and deductions in the manner set forth in that 1985 bulletin. *See* Taxpayer Ex. 1. More recently, the Department has regularly informed taxpayers that it considers retail sales of food in exchange for food stamps to be nontaxable sales to a governmental entity. *See, e.g.*, Letter Ruling Numbers 98-0216 (July 23, 1998); 93-0517 (Aug. 17, 1993); 92-0489 (Sept. 17, 1992).

Given the way the Department treats sales of food for food stamps, any documentation that would have corroborated the amount of the food stamp deductions "ABC" reported on its monthly returns would have sufficed to rebut the Department's determination to disallow that deduction. For example, had taxpayer offered a letter from the United States Department of Agriculture which indicated the amount of food stamps received by that agency from taxpayer, or statements from taxpayer's bank identifying the amount of taxpayer's food stamp deposits into its bank account, that documentary evidence would have corroborated "Razza's" testimony that taxpayer made sales of food in exchange for food stamps, and, to the extent they matched, the amount of the food stamp deductions "ABC" reported on its returns.

Here, counsel for taxpayer made the following arguments after both sides rested:

You've heard testimony from the taxpayer that he did provide documentation to the auditor regarding this audit. You've also heard testimony that he deposited all food stamp deposits into the bank account.

And you've heard nothing from the Department as to why they did not allow that deduction to stand.

We have deposits. We have verification from the Department of Agriculture, which he signed and authorized and he says he gave her [the auditor] books and records.

Without the Department telling you why they feel that the audit should stand, my client's testimony should stand at face value.

He gave documents to the Department. The Department chose to disregard those documents. We don't know why the Department chose to disregard the documents and come up with an audit finding.

And accordingly we believe that the audit itself should go back for a re-audit or the total amount should not be allowed since we don't have any explanation as to how they got to that number.

Tr. pp. 24-25.

This argument was made following the hearing taxpayer requested to challenge the assessment of tax the Department issued to it. It was at that hearing that taxpayer had the opportunity to offer whatever documents it had, or whatever documents it had previously tendered to the Department, to be reviewed by the person who was responsible for recommending to the Director whether the Department's assessment should be upheld or revised, or whether "ABC's" original returns were true and correct. The hearing, therefore, was not the time to ask that a reaudit be conducted.

Additionally, taxpayer seems to be under a misconception about who bears the burden to prove entitlement to a deduction claimed on a return. *See* 35 **ILCS** 120/7; 86 Ill. Admin. Code § 130.810(b). The Department's employees are not obliged to act as a taxpayer's agent and to seek out corroboration of the amount of deductions a taxpayer claims on its returns. Rather, it is the taxpayer's obligation to support its entitlement to such deductions with competent and credible evidence that is closely identified with its books and records. 35 **ILCS** 120/7; Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. Nor does an alj somehow obtain custody over, or knowledge of the contents of, whatever documents a Department

auditor might have previously reviewed while conducting the Department's audit of a particular taxpayer.

If taxpayer really had books and records that would have documented the amount of food stamps deposited into its bank account, or other documentary evidence to prove that the Department of Agriculture had verified the amount of food stamps it received from "ABC", the hearing was the time and place to offer such documents into evidence. Taxpayer, however, introduced no documentary evidence whatever to show that it actually received food stamps in the amounts reported as deductions on its returns, or in any amount. Proof of its entitlement to the deduction at issue should have been easy for "ABC" to document, yet it offered no such proof at hearing. Therefore, "ABC" has not rebutted the *prima facie* correctness of the Department's determination to disallow those deductions. See 35 ILCS 120/4; Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Conclusion:

I recommend that the Director finalize the NTL as issued, with interest to accrue pursuant to statute.

3/13/00
Date

Administrative Law Judge